



A New Generation of Energy

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DELAWARE POWER

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Overnight:
500 North Wakefield Drive
Newark, DE 19702

May 14, 2009

Ms. Karen Nickerson, Secretary
Public Service Commission
861 Silver Lake Blvd.
Cannon Building, Suite 100
Dover, DE 19904

RE: In the Matter of Integrated Resource Planning for the Provision of
Standard Offer Supply Service by the Delmarva Power & Light Company
Under 26 Del. C. Section 1007(c) & (d); Review of Initial Resource Plan
Submitted December 1, 2006, PSC Docket No. 07-20

Dear Ms. Nickerson:

Please find enclosed for filing, the original and ten (10) copies of Conectiv Energy
Supply, Inc.'s Response to Staff's April 2, 2009 Report in the above-captioned docket.

Sincerely,

A handwritten signature in cursive script, appearing to read 'David Rosenstein'.

David Rosenstein
Vice President and General Counsel

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

**IN THE MATTER OF INTEGRATED
RESOURCE PLANNING FOR THE PROVISION
OF STANDARD OFFER SUPPLY SERVICE BY
DELMARVA POWER & LIGHT COMPANY
UNDER 26 DEL. C. § 1007(c) & (d): REVIEW OF
INITIAL RESOURCE PLAN SUBMITTED
DECEMBER 1, 2006
(OPENED JANUARY 23, 2007)**

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**CONECTIV ENERGY SUPPLY, INC'S
RESPONSE TO STAFF'S APRIL 2, 2009 REPORT**

Pursuant to the approved procedural schedule in this case, Conectiv Energy Supply, Inc. ("Conectiv Energy") offers the following comments in response to the Commission Staff's April 2, 2009 "Review of Delmarva Power & Light Company's Integrated Resource Plan" ("Report"). In these comments, Conectiv Energy recommends the following:

1. That Delmarva not implement an actively managed portfolio ("AMP") unless and until the Commission issues an Order, based upon a full and complete evidentiary record, that the public interest requires replacement of a specific portion (between 0% and 70%) of the SOS supply acquisition process approved in Docket No. 04-391.
2. That Delmarva not implement an AMP unless and until the Commission issues an Order, based upon a full and complete evidentiary record, that the public interest requires use of the specific form of AMP that will be implemented.
3. That any determination regarding the need for new generation in Delaware be

based upon detailed cost estimates and power flow reliability modeling.

4. That, if the Commission determines that Delmarva should enter into a purchase power agreement for new generation in Delaware, any such purchase power agreement should be awarded on a competitive basis without any presumption that such generation will be located at a specifically pre-determined site.

Conversion from Full Requirements Contracts to Actively Managed Portfolio

Much of the supply-side portion of the Report focuses on Delmarva's transition from the SOS supply acquisition process (the Full Requirements Service or "FRS Process") as approved by the Commission in Docket No. 04-391 (the "SOS Supply Docket") to an in-house, actively-managed portfolio ("AMP") approach. Under the FRS Process Delmarva conducts a competitive solicitation with Commission oversight through which it enters into a series of full requirements purchase agreements for various terms.¹

Under an AMP, as described in the Report, Delmarva would make periodic direct purchases of power from counterparties under short-, mid-, and long-term contracts, perform its own financial hedging of these purchases, and physically balance its supply to actual load with spot market purchases or sales in the PJM energy market. Report at 21, 30-33. The Report refers to the AMP approach as being a "significant departure" from continuation of the FRS Process which was initially proposed by Delmarva in its December 2006 IRP Filing. Report at 29-30.

Conectiv Energy is a wholesale electric marketing company and has participated as a bidder in most, if not all, of the competitive solicitations conducted by Delmarva under the FRS

¹ The Commission has also authorized Delmarva to go outside of the FRS Process to enter into power purchase agreements with three land-based generators. The authorization in each case was based upon a full and complete evidentiary record.

Process. Conectiv Energy would also attempt to participate in opportunities to sell power to Delmarva under any short-, mid- and long-term supply arrangements entered into under AMP.² Thus, while Conectiv Energy hopes to continue to be a possible supplier in any supply acquisition efforts conducted by Delmarva, Conectiv Energy does not believe that the acquisition method already found by the Commission to be in the public interest should be abandoned without first going through the required evidentiary regulatory approval processes.

The FRS Process grew out of the Commission's investigation into the best way for Delmarva to meet its SOS load obligations. On October 4, 2004, the Commission issued Order No. 6490 in the SOS Supply Docket for the express purpose of "explor[ing] issues related to the selection of an SOS supplier for DPL's service territory and the appropriate prices to be charged for SOS after [April, 2006]". Over the next 12 months, pursuant to the Commission's directive, the Staff conducted a series of workshops and solicited oral and written comments on SOS supply from interested parties.

Based upon those discussions the Staff entered into a Settlement with most of the parties which recommended that Delmarva use the FRS Process to meet its SOS supply requirements. On August 4, 2005, the Hearing Examiner held a hearing on the Settlement. At the conclusion of the hearing, the record, consisting of 10 exhibits and a 676-page transcript, was closed. After the parties submitted their post-hearing briefs the Hearing Examiner issued his recommendation that the Commission order Delmarva to implement the FRS Process. On October 11, 2005, the Commission issued Order No. 6746 in the SOS Supply Docket in which it adopted the Hearing

² The Federal Energy Regulatory Commission ("FERC") currently permits Conectiv Energy to sell power to its affiliate, Delmarva, under contracts entered into pursuant to the highly structured FRS Process. Conectiv Energy does not know whether the FERC rules will limit, or prohibit, it from selling power to Delmarva under AMP. In the event that the FERC rules prohibit Conectiv Energy from making sales to Delmarva under AMP, the pool of competitive suppliers from which Delmarva will be able to make purchases will be reduced by one.

Examiner's conclusion that the FRS Process, as described in the Settlement, was "in the public interest and in compliance with state law".

Once it approved the FRS Process the Commission continued to revisit and refine that Process relying upon the same type of evidentiary record upon which it relied for its initial approval. For example, in Order No. 6943 issued on June 20, 2006, the Commission directed its Staff to explore and determine what changes to the FRS Process might be required by the Electric Utility Retail Customer Supply Act of 2006 ("EURSCA"). As with the original proceedings in the SOS Supply Docket, the Staff conducted a series of workshops seeking input from interested parties. As a result Staff was able to present to the Commission lists of "uncontested" and "contested" issues. The Commission heard oral argument from the parties on the "contested" issues and, on October 17, 2006, issued Order No. 7053 which modified the FRS Process.

The possibility of using AMP, rather than the FRS Process, for acquisition of SOS supply was first raised by the Staff in its Final Report filed in Docket No. 06-241 (the "RFP Docket"). The Commission opened the RFP Docket in response to EURSCA's requirement that the Commission and the other State Agencies evaluate proposals received by Delmarva in response to a request for proposals for new generation. The record in the RFP Docket dealt solely with the terms and conditions of a possible purchase power agreement between Delmarva and one of the three generation proposals. The RFP Docket did not address, and its record did not include evidence related to, the question of how Delmarva might meet the portion of its SOS supply requirements not met by the new generation. Under EURSCA, issues related to supply other than the new generation, were to be addressed in the Integrated Resource Plan proceeding or pursuant to separate applications filed by Delmarva. Section 1007(b).

The Staff, in its Final Report in the RFP Docket, recommended that the new generation issues be resolved by approval of a “hybrid approach” under which Bluewater Wind’s off-shore wind resource would be backed-up by an on-shore gas facility. Notwithstanding the limited scope of the RFP Docket, the Staff, in its Final Report, went on to recommend that the hybrid approach be part of an overall actively managed portfolio for acquisition of SOS supply consisting of the new hybrid model generation, demand side opportunities, short and long term purchases and bi-lateral purchase arrangements. The Staff’s recommendation was at a fairly high level and did not specify how the various components should be used in the AMP or, in particular, what role the FRS Process, previously found to be in the public interest by the Commission, might play in the AMP. In Order No. 7199 in the RFP Docket the Commission and the State Agencies adopted the Staff’s recommendation.³

In light of the above, there may now be a question of whether Order No. 7199, in and of itself, requires the “significant departure” from the FRS Process previously found by the Commission to be in the public interest. The Report seems to operate under the assumption that such a significant departure was mandated by Order No. 7199.⁴ Conectiv Energy submits that Order No. 7199 should not be interpreted as establishing such a mandate.

Conectiv Energy does not suggest that Staff’s recommended use of AMP, as approved by the State Agencies in Order No. 7199, should be ignored. Conectiv Energy simply submits that

³ Subsequently, in Order No. 7440, the Commission and the State Agencies reversed their requirement that Delmarva implement a hybrid approach. Instead, the State Agencies approved an agreement between Bluewater and Delmarva and deferred consideration of a possible back up gas facility until this IRP Proceeding. An argument could be made that this reversal of the Order No. 7199 mandate for a hybrid approach should also be interpreted as a reversal of the Order No. 7199 recommendation that Delmarva implement AMP for its SOS supply requirements. However, since, as discussed herein, the Staff’s recommended use of AMP in the RFP Docket must be viewed as merely a recommendation and not a mandate, the question of whether Order No. 7440 reverses Order No. 7199 on the use of AMP is not really substantive.

⁴ The Report goes on to suggest that all of the SOS supply can be acquired through AMP. As discussed below, Conectiv believes that EURSCA makes it clear that the FRS Process must continue to be used for at least 30% of the SOS supply.

Delmarva should not depart from the FRS Process, found by the Commission to be in the public interest, unless and until the Commission concludes, based upon a full and complete evidentiary record, that:

1. The public interest requires that a specific portion (between 0% and 70%) of the FRS Process should be replaced with AMP (the “proportionate use” of AMP);⁵ and
2. The public interest requires implementation of a specifically defined form of AMP (the “form” of AMP).

The RFP Docket, a proceeding that was not opened to address the broader issue of SOS supply and which did not include substantive evidence on the merits of the FRS Process versus AMP, did not contain the full and complete evidentiary record upon which the above described conclusions could be drawn. Instead, the Staff’s Final Report in the RFP Docket and Order No. 7199 must be viewed as the first step in a process, which after development of an adequate record, could lead to authorization of a specific proportionate use and form of AMP. However, no presumption regarding the proportionate use or form of AMP should be made prior to conclusion of the necessary evidentiary proceedings.⁶

Recent events, most importantly the collapse of the credit markets, suggest that such an evidentiary record may show that use of AMP is not as advantageous as thought by the Staff when it first recommended its use two years ago. In Maryland, the Public Utility Commission

⁵ The Report suggests that the AMP manager should be responsible for determining what portion of the SOS supply will be met through something like the FRS Process. However, Conectiv Energy submits that the question of whether, and how, to continue to use the FRS Process, a process which was the result of extensive public Commission proceedings, should continue to be determined by the Commission and not delegated to Delmarva’s in-house AMP manager.

⁶ Such a proceeding could be within the context of the SOS Supply Docket – the proceeding that the Commission has historically used to address the SOS supply method – or in some other proceeding as deemed appropriate by Delmarva and the Commission.

("MD PUC") is currently addressing the threshold question of whether to pursue AMP. In that proceeding, Baltimore Gas & Electric Company ("BGE"), a Maryland utility, has asked the MD PUC to defer its decision on AMP so that it can assess the effect of volatile commodity prices and the impact of the decline in credit markets on wholesale power procurement.⁷ At page 5 of its Motion, BGE offers the following:

Specifically, BGE urges the Commission to further consider the impact of counterparty credit risk, potential collateral costs, expected working capital needs and operational complexities associated with wholesale power procurement in light of existing circumstances....[U]tility portfolio management would likely increase costs and financial risks, and it appears certain that it would increase collateral requirements at a time when access to capital is severely constrained.

...

As BGE and others have explained in Case No. 9117, the Commission should not mandate utility portfolio management for a host of reasons, including: (a) it would expose residential customers to increased risks and price volatility; (b) the uncertainty associated with prudence reviews and transferring of risk to utilities; (c) the significant expense associated with duplicating the expertise and systems to manage the risk and hedging required to implement portfolio management; and (d) the lack of credible evidence that portfolio management will achieve lower costs for customers. This position is buttressed by the impact of continuing deterioration in credit and financial markets.

In response to BGE's motion,⁸ the Maryland Office of People's Counsel ("MD OPC") argues that the MD PUC already has sufficient evidence to reject the actively managed portfolio approach, in favor of full requirements contracts. At pages 4-5 of its Response, MD OPC states the following:

Considering that an actively managed portfolio involves an

⁷ *Motion to Consider the Impact of the Decline in Credit Markets on Wholesale Power Procurement*, dated February 4, 2009, Case No. 9117 ("Motion").

⁸ *Response of the Office of People's Counsel to the Motion to Consider the Impact of the Decline in Credit Markets on Wholesale Power Procurement*, dated February 19, 2009, Case No. 9117 ("Response").

element of very short-term purchasing (daily or monthly), it results in increased volatility and risk that would have to be overcome by expected price benefits. The full-requirements contracts provide a level of price certainty and risk mitigation that, if priced reasonably, is beneficial to residential customers.

The Maryland commission has yet to rule on BGE's motion.

In any event, the impact on Delmarva ratepayers of replacing some portion of the FRS Process with AMP will not be known until the issue is fully vetted before the Commission. Such a process will not take place if, as suggested in the Report, Order No. 7199 operates as a mandate for such a replacement.

The Statutory 30% Minimum Use of the FRS Process

Any proceeding that addresses the question of replacement of the FRS Process with AMP will have to consider the impact of EURSCA's requirement regarding continued use of purchases from the wholesale market. At page 33, the Report states:

It is our understanding that the statute's requirement for procuring 30% of need from wholesale competitive sources could be met with any form of wholesale procurement so long as it is 'competitive. If so, Delmarva would not be limited to FRS contracts for serving SOS load from the MGS, LGS and GS-P classes. The current portfolio proposal is much too restrictive in its assumptions of FRS requirements in this regard.

The Report cites the statute, at §1007(c)(1)(a) of Title 26, which provides:

At least 30 percent of the resource mix of DP&L shall be purchases made through the regional wholesale market via a bid procurement or auction process held by DP&L. Such process shall be overseen by the Commission subject to the procurement process approved in PSC Docket #04-391 as may be modified by future Commission action.

The statute clearly requires that at least 30% of Delmarva's resource mix (referred to herein as the "Reserved Component") consist of specifically defined purchases from the regional

wholesale market. The Report's contention that the Reserved Component "could be met with any form of wholesale procurement so long as it is competitive" contradicts the plain language of the statute. The statute refers specifically to a "bid procurement or auction process" which "shall be overseen by the Commission subject to the procurement process approved in the [SOS Supply Docket] as may be modified by future Commission action."

The General Assembly plainly endorsed the FRS Process by not only citing the actual docket but by separately requiring a "bid procurement or auction process held by DP&L," both of which methods are a part of the FRS Process.⁹ Any other type of competitive procurement for the Reserved Component would, therefore, violate both the spirit and the letter of the statute.

Conectiv Energy recognizes that the statute allows for future modification to the SOS Supply Docket process. Thus, an argument could be made that the Commission can simply redesign the FRS Process to consist of any type of procurement it chooses. The legislature, however, did not permit such an "end around" of the existing process.¹⁰ First, the statute requires that "a bid procurement or auction process held by DP&L" be used for at least 30% of the resource mix. This is more prescriptive than the Report's assertion that any competitive wholesale procurement will do. For example, spot market purchases (which are an important part of the proposed AMP) could, arguably, be considered competitive wholesale procurements since they are made pursuant to an auction process administered by PJM. Spot market purchases, however, do not meet the statutory requirement of "a bid procurement or auction

⁹ Conectiv Energy notes that the legislative endorsement of Docket No. 04-391 should be seen as a significant compliment to the Commission, its Staff, the Public Advocate, the Technical Consultant, Delmarva and the other stakeholders who have helped shape the process.

¹⁰ Conectiv Energy stresses that it would never expect the Hearing Examiner or the Commission to attempt to circumvent the statutory requirements in this manner. However, to avoid unnecessary discussion during this proceeding of a resource mix that does not meet the 30% requirement (as suggested in the Report), Conectiv attempts herein to refute, and quickly move beyond, this notion.

process held by DP&L.” As such, they could not constitute a portion of the Reserved Component, even if the FRS Process were revamped to provide for AMP.

Second, and more importantly, to alter the fundamental character of the FRS Process by simply rolling the entire SOS supply mix into a flexible, managed portfolio structure, would violate the General Assembly’s intent to preserve the FRS Process framework for the Reserved Component. The existing FRS Process, in its essence, consists of a solicitation of laddered FRS contracts from the wholesale market, whether by RFP bid procurement or by auction. Thus, an attempt to circumvent the Reserved Component requirement by reopening the SOS Supply Docket and overhauling this framework would conflict with the statute.

It is important to note here that the General Assembly did not define the Reserved Component as merely 30% of the resource mix. Instead, it defined the Reserved Component as *at least 30%* of the resource mix. If, and when, the Commission considers the merits of replacement of some portion of the FRS Process with AMP, it may very well find that it can achieve price stability at competitive levels by relying upon the FRS Process for much more than 30% of the SOS supply. After all, Boston Pacific Company, Inc. (“Boston Pacific”), the Commission’s Technical Consultant regarding wholesale markets, has repeatedly found that the FRS Process has been administered in a competitive manner and has “resulted in fair results for the ratepayers in Delaware.”¹¹ Moreover, the prices achieved by the process have remained stable from year to year. As seen in Boston Pacific’s Table Nine,¹² the winning bids for the Residential customer class for the last four years have been \$103.38/MWh, \$95.78/MWh, \$109.90/MWh, and \$103.49/MWh. The stability of the *retail rates* derived from these wholesale

¹¹ *Final Report of the Technical Consultant on Delmarva’s 2008-2009 Request for Proposals for Full Requirements Wholesale Electric Power Supply to Delaware’s Standard Offer Service Customers*, February 17, 2009, at 1.

¹² *Id.* at 18.

prices is even greater, as only one third of the residential load is procured each year under the three-year, ladder process developed in SOS Supply Docket.

New Generation

First, it must be stressed, that it is not a foregone conclusion that Commission-mandated new generation, whether utility-owned or constructed via PPA, would have a net positive effect on rates or service in Delaware. Conectiv Energy submits that new generation investment will take place in Delaware when the wholesale energy and capacity market signals indicate that new generation is needed in Delaware.¹³ Conectiv Energy, by way of example, is responding to market price signals by constructing merchant generation facilities in Delta Township, Pennsylvania (545 MW dual fuel combined cycle) and in Millville, New Jersey (100 MW dual fuel combustion turbine) without the aid or incentive of state-mandated PPAs. Presumably, when the price signals indicate that new generation is needed in Delaware, the market will respond with new generation.

Conectiv Energy understands that the Commission may not share its views on the efficiencies of the PJM markets and that it may choose to require new generation as a way to exercise greater control over supply in Delaware. In addition, the Report suggests that new generation in Delaware could reduce price risk to ratepayers by acting as a "buffer against extreme market prices" in PJM. Report at 33.

If the Commission decides that Delmarva should enter into a PPA with a developer of

¹³ According to The Brattle Group, an independent market consulting firm, PJM's Reliability Pricing Model ("RPM") has "been successful in achieving the stated reliability and economic objectives of RPM" and has "has already attracted and retained over 14,500 MW of resources that likely would not have been made available to PJM otherwise." To obtain these results, The Brattle Group found that "customers have paid capacity prices that are roughly consistent with resource adequacy balances and the administratively-determined marginal cost of capacity for the RTO...." *Review of PJM's Reliability Pricing Model (RPM)*, June 30, 2008, prepared for PJM Interconnection, L.L.C. ("PJM"), at 122.

new generation in Delaware, Conectiv Energy urges it to ensure a competitive process for selection of such a developer. In order to keep the selection process competitive, the Commission must guard against establishing bid parameters that, in effect, reduce the pool of potential bidders down to a single candidate. After all, without several viable bidders, it is highly doubtful that Delmarva and its ratepayers will receive power at the lowest reasonable cost.

Unfortunately, the State Agencies who participated in the RFP Docket have already indicated a State preference for a plant in southern Delaware, specifically at the Indian River generation site. In Order 7199, without even seeing competitive bids from prospective suppliers, the State agencies stated the following:

NRG's bid proposal may compare favorably due to NRG's pre-existing location in Sussex County, obviating the need to site a new power plant outside of an existing brownfield (one of the criteria outlined under EURCSA). NRG's existing location may also serve to minimize the costs and siting issues associated with new supporting transmission. Use of NRG's existing power plant site for gas-fired back-up generation may also incent the conversion of Indian River units 1-4 to cleaner natural gas.

Order 7199 at 30.

Conectiv Energy submits that there is currently no reason to favor a plant, either generally in southern Delaware, or specifically at the Indian River site. As noted in the Report, a series of transmission upgrades are planned throughout the Delmarva Peninsula including the Mid-Atlantic Power Pathway ("MAPP"), which is a major 500 kV backbone facility that will connect southern Delaware to the regional 500 kV grid. With these upgrades, and a new supply of power flowing to southern Delaware via MAPP, there will be even less reason to focus on Sussex County for new generation. Conectiv Energy is confident that these conclusions will be borne out if the Commission adopts the Report's recommendations to perform siting analyses,

cost studies, and power flow reliability modeling before determining whether, where and what type of new generation should be built in Delaware. Report at 49, 50.

In addition, the Report states that “we understand that [natural gas] is not available in sufficient quantities for a [gas-fired plant] at, for example, the Indian River site.” Report at 37. This observation alone should be enough to open up the siting alternatives to other areas in order to evaluate whether the ratepayers can realize costs savings from locating a plant in proximity to existing, adequate gas infrastructure, without compromising any electrical or other portfolio-related factors.¹⁴

Therefore, if Delmarva is directed to solicit purchase power proposals from third party generators in Delaware, Conectiv Energy urges the Commission to design evaluation parameters that do not favor any specific site or location within the State, but rather, ensure that the resulting power supply arrangement is in the best interests of Delmarva’s ratepayers.

Respectfully submitted,




I. David Rosenstein
Vice President and General Counsel
Conectiv Energy Supply, Inc.

May 14, 2009

¹⁴ The Report makes the somewhat troubling suggestion that a cost analysis for various sites “should consider ‘spin-off’ benefits to [southern Delaware] from any increased natural gas availability for non-utility customers.” Report at 37. This implies that the increased availability of natural gas for customers in southern Delaware could be deemed to justify some level of higher costs paid by electric customers for generation located in southern Delaware. These “spin-off” benefits, achieved through electric ratepayer subsidization, would constitute Commission support for a competitive advantage by the regulated natural gas provider in Sussex County over the alternative energy providers in that area, such as propane and heating oil dealers. Conectiv Energy submits that, if Delmarva had attempted to site a new generating plant in an area which required payment for a new unnecessary gas pipeline extension (back when electric supply and price was regulated) the cost of such natural gas line extension would have been excluded from rate recovery as being unnecessary and as violating Delaware’s “business judgment rule”. If Delmarva could not have burdened its ratepayers in this way, neither should the Commission.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served an original and ten copies of the foregoing petition by overnight delivery service on the Secretary of the Delaware Public Service Commission.

A handwritten signature in cursive script, appearing to read "I. David Rosenstein", is written over a horizontal line.

I. David Rosenstein
Vice President and General Counsel
Conectiv Energy Supply, Inc.

May 14, 2009